Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Soto	Analyst:	Darrine Distefano	Bill Number:	SB 438
Related Bills:	See Legislative History	Telephone:	845-6458	Amended Date:	January 12, 2004
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Disaster Loss Deduction/Excess Loss Carryover/Los Angeles, San Bernardino, Riverside, San Diego, & Ventura County Fires

SUMMARY

This bill would allow taxpayers special tax treatment, called disaster loss treatment, for losses sustained as a result of the Southern California wildfires that occurred in October and November of 2003.

This bill would also provide funding to local agencies from the state for financial assistance to repair or rebuild improvements to real property related to government services. This analysis will not address these changes to the Government Code, as they do not impact the department or state income tax revenue.

SUMMARY OF AMENDMENTS

The January 12, 2004, amendments deleted the provisions relating to state employees and added the provisions discussed in this analysis.

This is the department's first analysis of this bill.

PURPOSE OF THE BILL

According to the author's staff, the purpose of the bill is to provide immediate tax relief to individuals affected by recent California disasters.

EFFECTIVE/OPERATIVE DATE

As an urgency measure, this bill would be effective and operative immediately upon enactment.

POSITION

Pending

Summary of Suggested Amendments

Amendments are provided to add damage from floods, mudflows, and debris flows that occurred as a direct result of the wildfires and for damage that occurred as a result of the San Simeon earthquake.

Board Position:			Department Director	Date
_______ S	_______ NA	_______ NP		
_______ SA	_______ O	_______ NAR	Gerald H. Goldberg	2/13/04
_______ N	_______ OUA	___X___ PENDING		

ANALYSIS

FEDERAL/STATE LAW

Under federal and state law, a disaster loss occurs when property is destroyed as a result of a fire, storm, flood, or other natural event in an area proclaimed to be a disaster by the President of the United States or, for state law purposes, by the Governor.

Under federal and state tax law, the taxpayer may elect to claim the loss either in the year the loss occurs or in the year preceding the loss. This election allows the taxpayer to file an amended return immediately for the prior year. For state purposes, this election may be made prior to passage of any state legislation allowing special carryover treatment because California conforms to the federal election.

Nonbusiness disaster losses not reimbursed by insurance or otherwise are deductible under state and federal tax law to the extent each loss exceeds $100. Total nonbusiness disaster losses are deductible only to the extent that the total loss amount for the year exceeds 10% of adjusted gross income.

State tax law identifies specific events as disasters that are then allowed additional special carry forward treatment. That is, 100% of the excess disaster loss may be carried over for up to five taxable years, and if any excess loss remains after the five-year period, the remaining excess loss may be carried over at a specified percentage for up to 10 additional years.

THIS BILL

This bill would add the wildfires that occurred in October and November of 2003 in the Counties of Los Angeles, San Bernardino, Riverside, San Diego, and Ventura to the current list of specified disasters under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL). Specifically, this bill would allow special disaster treatment of losses sustained as a result of those wildfires. The $100 and 10% of adjusted gross income limitations in existing law would apply to disaster losses on nonbusiness property.

This bill would allow any remaining excess disaster loss after the five-year period to be carried over using the net operating loss (NOL) percentage that was applicable for the year the disaster occurred. The wildfires occurred in 2003 when the applicable percentage for NOLs was 60%. Therefore, if a taxpayer affected by the wildfires has any excess disaster loss remaining after five years, 60% of the remaining loss can be carried over for an additional 10 years.

This bill would also make various technical changes.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would not significantly impact the department’s programs and operations.

<u>TECHNICAL CONSIDERATIONS</u>

The Governor requested and the President authorized the Federal Emergency Management Agency to expand the disaster declaration to include floods, mudflows, and debris flows that were a direct result of the Southern California wildfires. The Governor has also declared the San Simeon earthquake a disaster. Amendments 1 and 3 are provided at the author's request to add to the list of specified disasters both the expanded damages resulting from the wildfires and to add language for losses resulting from the earthquake that occurred in the Counties of San Luis Obispo and Santa Barbara. Amendments 2 and 4 allow taxpayers affected by the earthquake to claim the loss either in the year the loss occurs or in the year preceding the loss.

LEGISLATIVE HISTORY

- AB 1X (Cardoza, Stats. 1997, Ch. X3) covered losses for the storms and floods of 1996-97.
- AB 2456 (Sweeney, Stats. 1998, Ch. 749) covered losses for the storms and floods of February 1998.
- AB 114 (Florez, Stats. 1999, Ch. 165) covered losses for the winter freeze of 1998-99.
- AB 44 (Wiggins, Stat. 2001, Ch. 618) covered losses for the earthquake that occurred September 2000 in Napa, California.
- SB 1147 (Hollingsworth, 2003/2004) is identical to SB 438, except for clarifying amendments. SB 1147 is in the Senate Rules Committee.

OTHER STATES' INFORMATION

Michigan, Minnesota, Massachusetts, and *New York* conform to the federal provisions that allow taxpayers to claim a disaster loss deduction on their state returns either in the preceding year or in the year of the loss. It appears that legislation, executive order, or proclamation by the President or the Governor is required to identify the area impacted by a disaster that is eligible for federal or state assistance.

Florida does not have a personal income tax. However, monetary relief is provided to citizens and corporations through the Emergency Management, Preparedness, and Assistance Trust Fund. Florida also requires legislation, executive order, or proclamation to identify the area impacted by a disaster.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

<u>Revenue Estimate</u>

Based on the discussion below, the revenue losses from this bill are as follows (assumes fast track legislation enacted before April 2004):

Estimated PIT Revenue Impact SB 438 as Amended January 12, 2004 with proposed amendments (In Millions) **Fiscal Year Impact**			
2003-2004	**2004-05**	**2005-06**	**2006-07**
Minor loss	-$5	-$9	-$4

Minor = Less than $500,000

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

The impact of this bill would depend on the amount of disaster losses carried back, carried forward at 100% instead of 60%, and the amount of carryover losses deducted in subsequent years.

The estimated losses were determined in several steps. First, it is assumed that the special disaster loss treatment provided in this bill would be for losses sustained as a result of the Southern California wildfires, the expanded wildfire disaster coverage, and the San Simeon earthquake. Second, the total amount of damages for the Southern California wildfires was estimated to be $2.8 billion and the total amount of damages from the San Simeon earthquake was estimated to be $34 million in private losses.

It is estimated that approximately 20% of fire damage and 90% of the earthquake damage would not be reimbursed by insurance coverage for a total deductible loss of $590 million ($2.8 billion x 20% + $34 million x 90% = $590 million).

In order for a taxpayer to calculate the amount of disaster loss that can be deducted, the taxpayer uses three factors. First, the loss must be limited to the basis of the property (cost of the property plus cost of any improvements minus deductions such as depreciation). Second, any insurance proceeds or reimbursements must be deducted. Third, the taxpayer subtracts 10% of their federal adjusted gross income (AGI). The remaining amount is the disaster loss that can be claimed by the taxpayer. Using the department's disaster loss model, after applying qualifying losses for AGI and basis limitations of $147 million and an estimated first year usage of $148 million (historical use of similar losses under current law), it is projected that $250 million in losses would be allowed to be carried forward under the bill ($590 million - $147 million - $148 million = $295 million).

At a 6% average marginal tax rate, the total revenue loss over a period of a few fiscal years is estimated to be approximately $18 million, all attributable under the PITL ($295 million x 6% ~ $18 million).

LEGISLATIVE STAFF CONTACT

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO SB 438
As Amended January 12, 2004

AMENDMENT 1

On page 5, line 20, strikeout "." and insert:

, or as a result of floods, mudflows, and debris flows directly related to the fires in those counties from October 21, 2003, through February 2, 2004.

(23) Any loss sustained as a result of earthquakes or any other related casualty occurring in December 2003 in the Counties of San Luis Obispo and Santa Barbara.

AMENDMENT 2

On page 6, line 16, strikeout "(22)" and insert:

(23)

AMENDMENT 3

On page 8, line 14, strikeout "." and insert:

, or as a result of floods, mudflows, and debris flows directly related to the fires in those counties from October 21, 2003, through February 2, 2004.

(23) Any loss sustained as a result of earthquakes or any other related casualty occurring in December 2003 in the Counties of San Luis Obispo and Santa Barbara.

AMENDMENT 4

On page 9, line 10, strikeout "(22)" and insert:

(23)